WOW! First Quarter Earnings Release Conference Call

Moderator: Rich Fish
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11:00 a.m. MT

Operator: Good afternoon, Ladies and Gentlemen, and welcome to the First Quarter 2014 WOW! Internet, Cable & Phone Earnings Release conference call.

As a reminder, I want to advise everyone that this call is being recorded. At this time, I would like to turn our call over to Mr. Rich Fish, WOW!'s Chief Financial Officer. Please go ahead.

Rich Fish: Thanks, Ryan. Good morning, everyone. Thanks for joining our first quarter earnings call. With me today, is WOW! CEO, Steven Cochran, who will be giving an update on our operating activities and then I'll cover the financial results for the quarter.

After that, we'll open it up for Q and A. Before we get started, we need to remind everyone that in our call, we'll be making forward-looking statements about our expected operating results, our business strategy and other matters relating to our business. We disclaim any obligation to update those forward-looking statements.

Those statements involve known and unknown risks, uncertainties and other factors that may cause our actual operating results, financial position or performance to be materially different from those expressed or implied in our forward-looking statements.

We discuss in our most recent Form 10-K some important assumptions in business risks that could cause our actual results to differ materially than those in the forward-looking statements and you should refer to the filing for a complete discussion of those risks.

In addition to these notes, in today's call within our earnings release, we refer to certain non-GAAP financial measures including adjusted EBITDA and pro-forma adjusted EBITDA. These measures are reconciled in our earnings release to the most comparable GAAP measures in our financial statements that's filed with the SEC.

So with that out of the way, I'll turn it over to Steven to give everyone an update on business.

Steven Cochran: Thanks, Rich, and thank you to everyone for joining. I'm sure most everyone has had a chance to look at our release and I will say that we are pleased with another strong quarter both in our customer activity as well as the financial results.

From a customer standpoint, despite one of the worst winters on record and pretty impacting storms across our markets, we were able to once again have very strong customer acquisition activity in the first quarter. We saw significant increase in both total customers and RGUs where we added just under 12,000 customers and 12,000 RGUs.

Once again, this was driven by HSD and probably even more so than we've seen in the past, really strong trends on the HSD side where we added just under 17,000 customers during the quarter. Once again we are able to see good growth across all of our markets. We had some that stood out, in particular, really strong trends in the southeast where we continue to see the benefits of the integration works and product improvements we've been performing throughout the acquired markets.

Another positive is in our Ultra TV, clearly an important product as we move forward on the video side. We've now seen where our Ultra TV sell-in has moved up to nearly 30 percent. In the quarter we added 11,200 Ultra customers, which takes us to over 80,000 at the end of the quarter.

So, really strong growth in Ultra TV and keep in mind that's just in what is the legacy WOW! market so that penetration is starting to be substantial relative to the base (of customers) who have that as a potential product. And so overall, this represented the second best quarter we've had for both customer growth and HSD growth in the last several years.

While we still had strong growth that came both from a connect standpoint as well as our continued low churn. On a quarter over quarter basis churn went to 2.4 percent compared to 2.3 percent, which given the rate increase, we were pretty happy with that churn number.

And so overall, just very happy with the customer activity we saw during the quarter just giving everything that was going on between rate increases and weather a lot of continued activity as we continue to make progress across the various markets from a product standpoint.

So while we managed the growth well and saw a nice customer growth, the one area that we did struggle on was from a rate increase standpoint. So just to give a little bit of background we historically have done pretty much one rate increase per year. We do the rate increase beginning in January and that is to basically offset the programming cost that we have for that year.

This year, it's spread out a bit more. We had our first rate increase in January, which gets implemented over the month of January. There is another piece of the rate increase that comes for our mid-Michigan and Lawrence systems because they were a little off cycle, which took effect April 1st.

Then we have a second kind of fee-related increase that was taking place during the middle of the second quarter and then another sports surcharge is going to come in place, in the southeast, around some product launch there in the third quarter.

So overall, we had planned for rates to come in throughout the year. The rate increase that we did in January wasn't as effective as we would have liked it to be from a stick rate standpoint. So I think our call center reps did a great job of saving customers into packages, probably we didn't do as well as we would like as far as the amount of rates that stuck.

So with that, we've got a little bit of makeup that we need to see going forward on the rate side as we implement these other rate increases and as we look for these other opportunities to kind of offset that impact. All that being said, we felt very good about the quarter overall in customer impact and even revenue in general.

From another segment of the business, our business services side, another strong quarter there. We launched new products in a number of markets that didn't have them. We launched Metro E, SIP trunks and Cloud Services. We have additional hosted voice that's going to come late in the second quarter.

These are primarily in what were the larger legacy WOW! markets, in Pinellas and in areas that didn't have these product offerings that we are now offering them. So that definitely increases what we are able to sell there and the ARPU that we should be able to generate through the customer base, basically the customers that we are attracted to in that market now.

So feel great about giving those product launches. There is a bit of ramp up time that goes following the products that we've had nice sales in all of the markets related to these products and continue to see a ramp as we move forward.

Overall sales we were very pleased with the funnel that continues to fill the amount of booked MRC that we continue to see. Our March represented the best month we've ever had and the quarter was the best quarter we've had and we expect to continue to see these kinds of results as we move forward just as we continue to get a more tenured sales force, as we get different channels which we are selling and as the new products take hold.

From a process standpoint on commercial, we've done a lot to develop the platform, but there is a lot work that we'll continue to do to support the back office side of it and continue to focus on the systems that are supporting the sales efforts that we have.

And overall, we continue to just build scalability into that business, we feel very good about how we are trending as far as the overall plan that we set out and the processes that are in place to date and will continue to be put in place.

And then, lastly, from an integration standpoint, the plan continues to move forward. Pinellas as many of you know was kind of the first priority and the first area of focus. We are almost done with our Pinellas integration at this point. During the quarter, we launched VOD and we increased HSD speeds.

We are now at 30 and 50 meg on the commercial side and 30 and 50 meg residentially. We also migrated our 7 and 8 meg customers to 15 meg. So still very solid about where we are from those products standpoint and then the Ultra TV is kind of the next and really the last piece of the true digital kind of overall integration efforts to get the product parody in that market place.

Additionally, we completed the all-digital conversion in Huntsville. We moved on to Columbus/Valley/Auburn, which we had our first channel drops in April. The second channel drops are happening literally, I think, this week and then we'll move on to the next market from there. So we'll continue to move forward with the all-digital conversions and then follow that up with Ultra launch following Pinellas and work through the processes around that.

So all in all, a very strong operational quarter, happy with the results and the continued focus and efforts that the teams have put in continuing to move to the one company mentality. So with that, I will turn it over to Rich to talk about the financial section.

Rich Fish: Thanks Steven. As I'm sure everyone has seen from the filings and the earnings release, total revenue and adjusted EBITDA for the quarter was $312.1 million and $109 million, respectively. Total revenue was up $7.7 million sequentially or 2.6 percent and represented an increase of $15.7 million or 5.3 percent on a year over year basis.

Pro-forma for the addition of BlueMile to the first quarter of 2013, total revenue was an increase of $13.5 million or 4.5 percent on a year over year basis. Adjusted EBITDA was up about a half a million sequentially and represented an increase of $4.4 million on a year over year basis or 4.2 percent.

Pro-forma for the addition of BlueMile from the first quarter of last year, adjust EBITDA represented an increase of $3.7 million or 3.5 percent on a year over year basis. On a combined basis, total subscription revenue was $281.7 million for the quarter, which was an increase of $5.9 million or just over 2 percent sequentially.

Of that quarter over quarter increase $3.6 million of that was attributable to volume as a result of strong subscriber activity that Steven spoke about, during the quarter specifically the increase of the almost 17,000 HSD subs, which is one of the best quarter we've had for HSD additions in at least a couple of years.

The remainder of the sequential increase, or $2.3 million, was derived from the customer rate increase during the first quarter. Year over year, total subscription revenue was an increase of $7.6 million or 2.8 percent and 100 percent of that year over year increase was driven by the exceptional customer acquisition trends.

It really started in the last half of 2013 and has continued into the quarter. For the year over year basis, we've added over almost 50,000 HSD subs from the end of the first quarter of last year.

Subscription ARPU was up on a sequential basis by about 90 cents per subscriber as a result of the first quarter customer rate increase. And Other Commercial Revenue for the quarter totaled $6.5 million, which was up on a sequential basis by $800,000 or 14.3 percent, and represented an increase of $1.9 million or 41.5 percent on a year over year basis and that's as a result of the acquisition of BlueMile, which was closed in the third quarter of 2013.

Other revenue for the quarter totaled $23.9 million, which was an increase of $1 million or 4.3 percent sequentially and was up $6.2 million or just over 35 percent on a year over year basis. Both the sequential and the year over year increases were driven by increased ancillary customer billings that Steven spoke about such as late fees, reactivation fees, service protection plan, installation revenue, et cetera.

So as I mentioned earlier, reported adjusted EBITDA for the quarter totaled $109 million taking into account the pro-forma impact of BlueMile for the first quarter of last year, on a year over year basis, adjusted EBITDA would have been increased by roughly $700,000 to $105.3 million representing an increase on a year over year basis of pro-forma adjusted EBITDA of $3.7 million or 3.5 percent.

CAPEX for the quarter totaled $49.4 million. In addition, we had a pay down in CAPEX related working capital during the quarter totaling about $3.5 million. So we reported total cash outflows in our statement of cash flows in our 10Q relating to CAPEX during the quarter of $52.9 million.

From a leverage standpoint, senior secured leverage at the end of the quarter, pro-forma for BlueMile was 4.6 times EBITDA and total leverage also pro-forma for the impact of BlueMile was 6.9 times.

And then lastly as most of you know, I just wanted to highlight that on April 1st, we closed the $100 million tack-on to our 10.25% notes. The proceeds were used to pay down the outstanding balance on our revolver at the end of the quarter of $92 million. So leverage ratios at the end of the quarter, pro-forma for the new issuance, were unchanged from what I just spoke to.

So that concludes our prepared remarks. I'll turn it back over to Ryan to now open it up for questions.

Operator: At this time, Ladies and Gentlemen, if you would like to ask a question, please press star then the number one on your telephone keypad. Your first question comes from the line of Mike Pace from JP Morgan. Your line is open.

Mike Pace: Hi, thanks. I just wanted to dig in a little bit more on the rate increase that you took and what you expect to do. You think you'll use it for four different times? So can you size what you did in January, I'm guessing you'll do something similar, I think you said, in April with those other systems and then you mentioned two others, I guess, fees in the second quarter.

Can you just explain what that is? Size that for us and the same thing for the sports surcharge. I'm just wondering you said that it didn't stick as well as you hoped. What are you going to try to do differently for these other increases?

Steve Cochran: Yes, thanks Mike. The first rate increase was kind of our typical increase it goes to about 60 percent of the base and it's just kind of what our normal package rate increase is. We got a decent number of people who are rolling off the bundle so it's the first time they are getting increased. But it's also the more long tenured customers who are no longer in one of our price guarantees. And so they are coming across in the rate increase.

And so generally, I think the planned amount was in the ball park of $6 average for customers who actually got it. So it was supposed to be about $4.5 if you took it across the average customer base.

So we are supposed to get $4.50 per customer, what stuck was about $2.90 per customer and so, there is definitely a short fall in revenue that, obviously impacted the quarter, but will impact going forward.

The second rate increase we talked about was really just mid-Michigan and Lawrence that because of the timing of when those were acquired and what their rate increases had been. We've kind of been moving it up a little bit each year to get them back on cycle. So last year, I think their rate increase was May 1st or actually it might have been June 1st.

We've moved it this time to April 1st. We'll try and get them on cycle with everyone else next year, but just instead of having two overall rate increases within six months trying to ease them back into it. So nothing significantly different from that one other than what is normally done here.

For the mid-May rate increase, there is a combination of things we are doing. Some of it is taking up some ancillary fees for instance on modems, and a lot of this is really to do one of two things. Either get us in line so that both the Legacy Knology and Legacy WOW! systems are at the same price point. And then also just where competitively things have went. So one of the things we are doing is increasing modems cost. That is more in line with what our competitors are charging in the market place.

Another is to increase our service protection plan. It's similarly that is more in line with where the market is on that and actually aligning both plans with Legacy WOW and Legacy Knology, and then there is a number of other more, as you go type cost, so things around late fees and reconnect charges and some of those kinds of more ancillary fees that are aligned as much to drive additional revenue, but also to drive customer behavior where some of the plans we've had in place, historically, I don't know that we've necessarily forced our customers to be as responsive and accountable as they need to be in the timeliness and so making some of those types of changes. And then lastly, a planned fee around a sports surcharge that will probably happen later in the year in certain markets.

So does that answer your question Mike? The other part was you asked what we were going to do differently. Clearly there are lessons learned anytime you go through one of these processes. I think the one thing that probably hurt us more than anything was because of some of the issues we dealt with in the billing conversion last year.

I think some of our representatives definitely got in the mindset of save a customer at all cost and in that a willingness to move customers into the current packages that are out there. So saving a customer into, the new WOW guaranteed package for two years, versus just applying a discount, or pushing back as much as we probably need to on some of these rate increases.

And so there was some system changes that were made between the first rate increase and the second rate increase. There was also a certain amount of coaching that was done with our representatives to make sure a continued focus on maximizing the ARPU when we go through a rate increase process.

Mike Pace: And just what is the size of the sports surcharge that you are expecting right now?

Steven Cochran: It is still up in the air. I don't think we finalized it yet, some of it that depends on some contractual negotiations that are going on, on the cost side.

Mike Pace: Gotcha. Maybe one for Rich, I guess, I saw in your 10Q, there is an increase in programming cost around $7 million. We don't have the exact programming line item, but kind of estimating that's up high single digits, maybe 10 percent or so, on a per unit basis. So can you just confirm those numbers and then just the timing of programming costs for the year? Are there any other affiliate agreements that will accelerate that programming cost throughout the year and then one more follow up for probably Steven?

Rich Fish: Yes, Mike you're correct on the percentage. We spoke to it in the MD&A. I think later in the year in, I believe, the second quarter, we have additional contracts that are up for renewal.

Steven Cochran: We have one that basically got a lot of press coverage that was effective April 1st that was an increase. We also have a contract, one of our larger contracts that are expiring August 1st, and then another one that, probably not as significant, but still relevant at the end of September.

We feel that we budgeted appropriately for those and they are reflected in that, but yes, a little unusual because normally this is a piece of our business we take our hit January 1st and that's kind of it for the year. Just a couple of exceptions this year that's driving that to be a little different.

Mike Pace: Just on commercial, I guess, you know, where are you now with what you own versus where you want to be and then is there just an update on any of the other smaller BlueMile type transactions that I believe you've been looking at?

Steven Cochran: Yes. So from a where we are standpoint, I think we are where we expected to be from a plan standpoint, I think we've still got new products to launch. We just hired a VP of channel sales so looking into a new line of that. We just started our third party outsourcer who is basically mining data, building, and continuing to build the database.

So there's still a lot of work going on. Some of the software that we are putting in place for processes is still moving. We've just signed a number of MSAs with a lot of the larger proprietors that really should help us move forward on the wholesale side.

So, we are moving in the direction we want to. We've still got a lot to accomplish and a lot of work behind it. So by no means do we feel we are even close to "there", but we are definitely tracking according to the plan that we laid out when we first started this process.

From an acquisition standpoint, we continue to look at opportunities. We have a couple of them that we thought were a little more viable that ended up not being. We still have a couple that we are working on as we speak, and we'll continue to actively pursue those acquisitions that we feel can kind of help our strategic plan on the commercial side.

Mike Pace: OK, thank you.

Steven Cochran: Thanks Mike.

Operator: Your next question comes from the line of David Phipps from Citi. Your line is open.

David Phipps: Hi. Thank you for taking my questions. Can you talk about some of the surge in the high speed data customer? Is it that you've upgraded things in the system? You've created a new marketing package? Just kind of thinking about how customers have decided that March quarter was a good time to add?

Steven Cochran: No. Honestly, I'll say that it is a continuation of what we've seen. Just – so I would say in the Southeast, there is definitely a piece where we've continued to improve the product. We did have some issues from the Legacy Knology side of delivering the speeds we were saying we were delivering and some outage related issues.

Those kinds of things that definitely we've fixed and is better not necessarily that we've upgraded speed as much, but for instance in Pinellas, where we saw a pretty nice HSD growth. Before we came in we had a 7-meg product. So clearly there is attractiveness there, but I think much more globally, it's just that continued push. For us, it was an interesting dynamic in this quarter especially in January right around the rate increases. The one thing we did see was really strong HSD growth when the video piece was struggling a bit.

So we continue to see a migration towards a more data focused product. I think as we sit here in April, we are in the ball park of almost 70,000 more HSD customers than we have video now. So there is a continued migration for us as a company to being a more focused HSD company and some of it is directionally that's where we would like to go, but some of it is programming cost are forcing consumers to go there.

And so I think it's just an alternative entertainment source that, historically, it might not have been that. That's the way to watch Netflix and Amazon and some of those kinds of things, and as our programming costs continue to rise, forcing some consumers to make that decision.

David Phipps: And as we go through seasonally, your margin seemed to always pick up in the second, third quarters and your net adds kind of taper down a little bit. This year, was there anything unusual in the past couple of years that would change that kind of seasonality?

Steven Cochran: No. I would expect that to be the same. I mean, with the number of university towns we have, we always see a little bit of that. Summers are always a little bit slower in general. We do have these unusual fees and that this year we have extra rate increases going on, but we also have programming increases that are happening kind of mid-year as well.

I think we will see a lift in margin. It may not be as dramatic as it has been historically because of those later in the year programming cost increases. But in general, I think that's right. I mean, I think we feel very good because we are out and ahead of budget from a units standpoint.

April was a fine month and we continue to see OK growth, but the second quarter is never going to be as strong as the first quarter and then, the third quarter we would expect to see that that bounce back that you don't get during the second.

David Phipps: And finally, on the CAPEX plan, do you still look for something over the $200 million range for the year?

Rich Fish: Yes, I think our guidance for CAPEX for the year, David, was in the $245 to $250 range. So we are still looking at that. First quarter capex is $50, $49, something like that, $49.4 so we are tracking. Obviously the first quarter is a little light relative to that run rate. But that's just a reflection of the number of projects that are in the early stages of being a project for the year, i.e. permitting and that type of stuff. So we would expect CAPEX to pick up in the balance of the year and are still looking at that kind of $250-ish number.

David Phipps: And finally, kind of as we get through this year, are we working our way downwards on some of the non-recurring items? That number keeps moving down.

Rich Fish: Yes, that's a trend that will continue. Generally I would say for the most part by the end of this year that will be kind of out of our cash flow. It may be a small amount that bleeds into next year, but certainly the trend is as you suggested.

David Phipps: All right, thank you. That's all my questions.

Operator: Your next question comes from the line of Davis Herbert from Wells Fargo. Your line is open.

Davis Hebert: Good afternoon, everyone. Thanks for taking the questions. A lot of moving parts on the cable consolidation front. Just wanted to know how you guys are looking at the change in footprint relative to WideOpenWest and Legacy Knology from Comcast and Charter standpoint.

Steven Cochran: Yes, obviously, pretty interesting times for us here evaluating that. Clearly when the Comcast and TimeWarner deal was announced, we've faced those guys for a long time and were expecting to deal with whatever came from that and knew that we had about I think 140,000 or so customers that would move from Time Warner markets into Comcast markets.

It was kind of position us to deal with that. When the Charter news came out that obviously changed things pretty significantly in that now we would look to see where we have almost 450,000 customers that are going to move to being a Charter related competition.

So you know a pretty big chunk of our overall customer base that's going to be Charter. I don't think we necessarily look at one versus the other and say, good or bad. I think the one thing that usually does turn out to be good for us though is that a large number of our customers are going to be going through some form of disruption and we have had a good trend of when markets were acquired, that our competitors acquired in markets that we served, usually is pretty good for us for a period of time as they go through transitions and whether it's billing conversions or watching the services or branding changes, whatever that is. And so from that standpoint it's probably a net positive that we are going to have more customers going through transition. But yes, we obviously continue to monitor it and watch what's going to be happening in our markets because it's pretty substantial right now.

Davis Hebert: OK, that's good enough. And then just not as familiar, is your voice product in house or is it through a third party?

Steven Cochran: Yes, it's all in house.

Davis Hebert: It is in house. OK, thank you.

Steven Cochran: Sure.

Operator: Again, if you'd to like to ask a question, please press star one on your telephone keypad. We have no further questions in the queue. I would now like to turn our call back over to the presenters.

Steven Cochran: Great. Well, we thank you guys for participating as always and thanks for the show of support for WOW! and look forward to talking to you next quarter.

Operator: This concludes today's conference call. You may now disconnect.

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